WEEKLY UPDATE

Let's Talk About Tax

In last week's Weekly Update, we described President Biden's massive push towards fiscal stimulus, the $2.26 trillion American Jobs Plan. Unlike the American Rescue Plan – the $1.9 tn bill he signed in March to provide pandemic relief to households and small businesses – this plan will not be financed by borrowing but rather by increased taxes. Will the added tax burden slow the recovery? And what does all this mean for markets?

To pay for the American Jobs Plan, the Administration intends to increase the tax burden on US companies. This was to be expected – Joe Biden's electoral platform included a partial repeal of Donald Trump's massive 2017 tax cuts, which reduced statutory corporate tax rates from 35% to 21%. The President now wants to increase the rate to 28% which should raise enough revenue over the next 10 years to pay for just under half of the stimulus plan. The remainder of the amounts required will be raised by taxing a larger proportion of US companies' overseas profits. The Trump administration introduced a tax on global intangible low-taxed income (GILTI) in December 2017, set at half the 21% statutory rate, i.e. 10.5%. Biden now plans to double the GILTI tax to 21%, to eliminate certain deductions for foreign income and to establish a new minimum tax on large companies' book income. According to a study by the Penn Wharton Budget Model, these measures in aggregate should raise $2.1 tn over the next 10 years.

However, this proposal would mean a sharp increase in costs for US-based multinationals, raising the risk that companies might seek new domiciles in lower-tax jurisdictions. It is no surprise therefore that US Treasury Secretary Yellen has signalled this week her willingness to accelerate talks on a global minimum tax rate. These discussions have been coordinated by the OECD in recent years and have included proposals for a digital services tax (DST), which would enable governments to tax revenues and profits generated by technology and internet companies with no physical presence in the country. The DST proposal was fiercely resisted by the Trump Administration, which viewed it as blatant discrimination against US digital leaders – the US reacted with a "safe harbour" measure, allowing US companies to opt out of compliance with the DST.

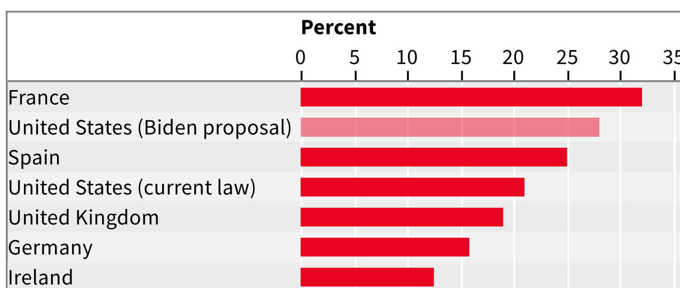
Janet Yellen's shift in stance marks a return to multilateral engagement with international institutions, in contrast to Trump's strict "America First" doctrine. She has proposed that the global minimum tax be set at 21% and signalled that the US would abandon the safe harbour policy. While this shift will be welcomed by the European Union, which has been advocating both a global minimum rate and a DST, it is by no means certain that a quick agreement can be reached.

First, the OECD's discussions have revolved around a 12.5% minimum rate. An increase to 21% will likely be resisted by countries like Ireland which have successfully used their low tax regimes to attract inward investment and jobs. Second, countries have very different needs for tax revenue. According to the OECD, government expenditure as a percentage of GDP varies widely, ranging from 24.5% in Ireland to 38.1% in the US to 55.6% in France. Third, there is sure to be strong opposition from Republicans and some moderate Democrats in Congress to Biden's tax proposals. Biden cannot afford to lose more than 3 Democratic votes in the House and none in the Senate if he is to get the legislation through. Finally, the Biden White House has not given up on punitive tariffs – the US Trade Representative still plans up to 25% tariffs on some imports from 6 countries – including Italy, Spain and the United Kingdom – which have introduced DST legislation.

Bottom line. Rapid rises in global corporate taxes are unlikely and President Biden may be forced to compromise on his planned increases. This means that budget deficits are likely to remain under pressure, encouraging central banks to maintain easy monetary policy settings. Regarding equities, 2017 showed that changes in the tax code do not have a lasting impact on stock market performance – our preferences for cyclically-sensitive sectors and markets and Value stocks remain unchanged.

US tax rate would be one of the highest in the OECD

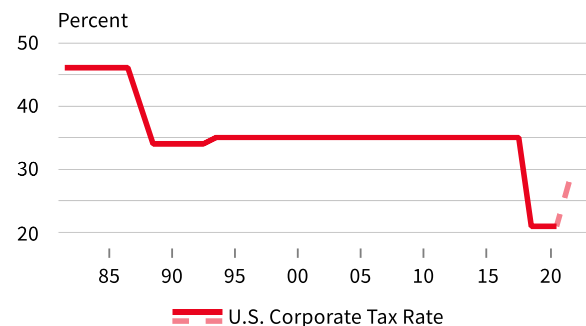
Statutory national corporate tax rates



Sources: SGPB, Macrobond, OECD, Tax Foundation, 09/04/2021

Despite the increase, the tax rate remains at low level

Evolution of U.S. corporate tax rate



Sources: SGPB, Macrobond, OECD, 09/04/2021

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OUR MACRO COMMENTS

This week and next

EUROZONE

- The Euro zone composite PMI increased from 48.8 to 53.2 in March, better than the 52.5 flash estimate.
- Germany's composite PMI came in at 57.3 in March, above forecasts at 56.8 and well ahead of February's 51.1. In France, the composite hit 50.0, up from the previous month's 47.0.
- Unemployment in Euro zone remained stable in February at 8.3% whereas economists had forecast a slight decrease to 8.1%.
- Germany's industrial production fell -1.6% MoM in February, after -2.0% in January, whereas the consensus expected 1.5% growth.

Next week's key events		*Per.*	*Prev.*	*Cons.*
12 Apr	Euro zone retail sales YoY	Feb	-6.4%	-5.3%
15 Apr	Germany HICP YoY	Mar	2.0%	1.6%

UNITED KINGDOM

- The composite PMI jumped to 56.4 from 49.6 in February, back into expansion territory above 50.0 for the first time in three months.
- The construction PMI came in at 61.7 versus 54.6 expected, its highest level since September 2014.

Next week's key events		*Per.*	*Prev.*	*Cons.*
13 Apr	Manufacturing production MoM	Feb	-2.3%	0.8%
13 Apr	GDP MoM	Feb	-2.9%	0.5%

UNITED STATES

- FOMC Minutes indicated that Fed members believed that the economy was rebounding faster than expected but remained focused on providing strong support to markets
- The trade deficit jumped 4.8% to a record $71.1 billion in February as economic activity rebounded quickly on easing restrictions and could remain elevated this year.
- In the week ending 3rd April, initial claims for unemployment benefits rose from a revised 728k to 744k whereas economists had forecast claims to fall to 680k.

Next week's key events		*Per.*	*Prev.*	*Cons.*
13 Apr	Core CPI YoY	Mar	1.3%	1.5%
15 Apr	Retail sales MoM	Mar	-3.0%	4.7%

ASIA & EMERGING

- China's CPI rose from -0.2% to 0.4% YoY in March, above 0.3% expected. Producer prices rose from 1.7% to 4.4% YoY in March, above the 3.5% expected.
- China's Caixin services PMI came in at 54.3 in March from 51.5 in the previous month and well above the 51.7 expected.
- Japan's household spending fell 6.6% in February from a year earlier, down for the third straight month under the country's second state of emergency over the coronavirus pandemic

Next week's key events		*Per.*	*Prev.*	*Cons.*
16 Apr	China GDP YoY	Q1	6.5%	18.3%
16 Apr	China retail sales YoY	Mar	33.8%	27.2%

Sources: DataStream, Bloomberg, 9 April 2021. Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, PMI = Purchasing Managers' Index, CPI = Consumer Price Inflation.

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.19	1.19
GBP/USD	1.37	1.38
EUR/CHF	1.10	1.10
USD/JPY	109.3	107.0
Brent	$63.3	$65.0
Gold (oz.)	$1756	$1750

NB No changes to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

THIS WEEK'S Q&A

What is the outlook for the Turkish lira against USD?

Volatility returned to trading in the Turkish lira (TRY) in mid-March. Out of the blue, the Central Bank of Turkey (CBRT) governor Naci Agbal was replaced by Sahap Kavcioglu on 19 March. This was the third time a governor has been replaced in past two years, a sign of erratic policy-making by President Recep Tayyip Erdogan. Kavcioglu is an ex member of parliament for Erdogan's AKP party, and is viewed as a loyalist.

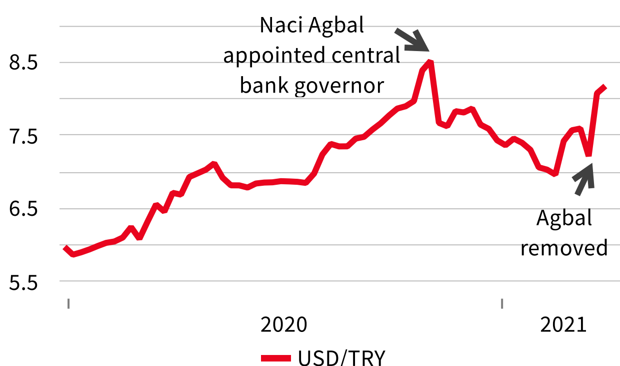
Agbal was appointed last November and proceeded to raise rates from 14.8% to 19% in an attempt to stabilize the currency and rein in inflation. Markets were reassured by Agbal's conventional approach to monetary policy – his predecessors had followed Erdogan's unorthodox doctrine that high interest rates cause high inflation and had kept rates too low for too long.

Agbal courted Erdogan's displeasure when he hiked rate by 200 basis points on March 18, and was summarily dismissed the next day. During his tenure, the TRY had gained 18% against the dollar, only to tumble -7.5% on the announcement of his dismissal.

Before his appointment, Kavcioglu signalled his loyalty to Erdogan's policies in column in a pro-government newspaper, stating that "interest rate increases will indirectly lead to an increase in inflation", a view which runs counter to most macroeconomic theories. The CBRT issued a statement that there would be no emergency monetary policy committee meeting. The next scheduled one is on April 15, and the likelihood has risen that there will be a cut in rates, perhaps a large one.

Turkey's external position is weak – HSBC estimates a $218bn external financing requirement over the next 12 months, which amounts to more than one quarter of GDP. This means that the country could face a funding shortfall as the current account deficit widens, unless capital inflows accelerate significantly.

The recent change of guard at the CBRT is unlikely to inspire much confidence among international investors, many of whom have kept an underweight position in Turkish assets in recent years. For example, less than 50% of Turkish sovereign bonds issued in foreign currencies is held by non-residents, the majority being owned by domestic investors. Given these factors, portfolio inflows are unlikely to provide the funding which Turkey so sorely needs.



Sources: SGPB, Macrobond, 08/04/2021

Another potential source of funding could be de-dollarisation of FX deposits by Turkish residents (corporate and households) – FX deposits (mainly in USD) have risen from below 30% of all deposits in the banking system to around 55% since 2010. However, a massive switch back into TRY deposits would require restored confidence in the currency, again unlikely in the foreseeable future with inflation risks tilted to the upside.

Turkish economy. GDP growth slowed markedly in Q4 2020, from +15.9% QoQ to +1.7%, well below the consensus estimate of +3.7%. Although Q1 2021 should show some improvement, the quarter is set to end on a weak note, as witnessed by the slump in YoY loan growth from mid-2020's 60% to around 5% in March. This being said, 2021 should still show strong growth from last year's low point. The carry-over effect is so strong that, even is QoQ growth is zero this year, YoY growth would still reach +5.7%. all workers. The consensus forecast is even more pessimistic at +4.8%.

Moreover, Turkey is likely to run a sizeable twin deficit this year – the budget balance should show only marginal improvement from last year. According to the Bloomberg consensus, the budget deficit is projected at -4.6% of GDP after -5.3% in 2020.

Similarly, the current account deficit is likely to improve only modestly this year, on the back of higher average oil prices and weak tourism revenues. The consensus forecast is -3.0% of GDP after -5.1% in 2020, with risks being skewed to the downside.

Core inflation has been trending steadily higher since reaching multi-decade lows at 2.5% in late 2010. It traded between 7.5% and 10.0% in 2015-2017 before shooting up to 24.3% in late 2018 during the currency crisis. In recent months, currency weakness has again pushed core inflation higher, reaching 16.9% in March. With key rates likely to be cut at April's meeting, we would expect the currency to continue to shed ground, keeping upward pressure on inflation.

Finally, the labour market is projected to remain very weak with the unemployment rate forecast at 12.4%, above the 10.6% average between 2014 and 2018. This in turn is likely to keep consumer confidence and retail sales at depressed levels throughout 2021.

Bottom line. Given the structural weaknesses in Turkey's economy and external position, the path of least resistance for the currency is downward. With rates set to be cut in coming weeks, we would expect USD/TRY to hit 8.50 in the next three months and 8.75 on a 12-month horizon.

MARKET PERFORMANCE

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-0.49 %	0 bp	→	-1 bp	1 bp	-4 bp
3mth Euribor (EUR)	-0.55 %	-1 bp	→	1 bp	0 bp	-29 bp
3mth Libor (USD)	0.19 %	-1 bp	↓	-4 bp	-5 bp	-112 bp
3mth Libor (GBP)	0.09 %	0 bp	→	6 bp	6 bp	-60 bp
10-year US Treasury bond	1.63 %	-5 bp	↓	53 bp	72 bp	87 bp
10-year German bond	-0.33 %	-1 bp	→	18 bp	24 bp	-2 bp
10-year French bond	-0.08 %	0 bp	→	23 bp	26 bp	-25 bp
10-year UK bond	0.75 %	-5 bp	↓	46 bp	55 bp	37 bp

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.1%	↑	-0.5 %	-0.3 %	8.6 %
BAML EURO Corp HY	0.3%	↑	1.4 %	2.1 %	20.4 %
BAML GBP Corp IG	0.5%	↑	-3.2 %	-3.8 %	7.8 %
BAML US IG	0.3%	↑	-2.2 %	-3.5 %	9.3 %
BAML US HY	0.6%	↑	1.5 %	1.7 %	24.8 %
BAML Global EM Sov. External Plus	0.8%	↑	-3.7 %	-4.3 %	18.7 %

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.19	1.2 %	↑	-2.5 %	-2.5 %	9.7%
EUR/CHF	1.10	-0.7 %	↓	1.8 %	1.9 %	4.4%
GBP/USD	1.37	-0.7 %	↓	1.2 %	0.4 %	10.9%
USD/JPY	109.3	-1.2 %	↓	5.1 %	5.8 %	0.4%
USD/BRL	5.57	-2.4 %	↓	2.9 %	7.3 %	8.8%
USD/CNY	6.55	-0.2 %	↓	1.2 %	0.4 %	-7.3%
USD/RUB	77.0	0.9 %	↑	3.9 %	4.0 %	2.5%

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.3 %	↑	-1.2 %	-1.7 %	-0.6 %
United Kingdom (3-7yr)	0.1 %	↑	-1.3 %	-1.6 %	-0.5 %
Germany (3-7yr)	0.0 %	→	-0.4 %	-0.5 %	0.0 %
Japan (3-7yr)	0.0 %	→	0.0 %	-0.1 %	-0.2 %

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	693	1.8 %	↑	4.9 %	7.7 %	52.9 %
Eurostoxx 50	3 978	0.9 %	↑	9.6 %	12.6 %	43.3 %
DAX	15 203	0.6 %	↑	8.2 %	10.8 %	47.1 %
CAC 40	6 166	1.0 %	↑	8.2 %	11.4 %	41.8 %
S&P 500	4 097	2.0 %	↑	7.5 %	9.5 %	51.5 %
FTSE 100	6 942	3.1 %	↑	2.1 %	8.6 %	26.4 %
SMI	11 207	0.9 %	↑	5.3 %	6.2 %	22.2 %
Topix	1 952	-0.3 %	↓	6.2 %	9.1 %	39.7 %
IBOV Brazil	118 313	2.7 %	↑	-5.4 %	-0.6 %	50.5 %
MICEX Russia *	3 508	-0.6 %	↓	1.5 %	6.7 %	31.4 %
MSCI EM	1 343	0.6 %	↑	-0.3 %	4.5 %	57.5 %
SENSEX 30 India	49 746	-0.6 %	↓	2.2 %	4.4 %	68.2 %
Hang Seng (H-K)	29 008	0.2 %	↑	4.4 %	6.9 %	25.2 %
Shanghaï Composite	3 483	0.5 %	↑	-2.5 %	0.3 %	23.7 %

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$63.3	-2.5 %	↓	13.0 %	22.1 %	92.5 %
Gold	$1 756	1.5 %	↑	-5.3 %	-7.5 %	6.5 %
Copper	$9 018	2.5 %	↑	11.1 %	16.4 %	81.2 %

Source: DataStream, on 8 April 2021.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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